TAX COURT CASE UPDATE

Citation:

George Gorra et ux. v. Commissioner, T.C. Memo 2013-254, November 21, 2013.

Overview:

The Tax Court has ruled that a married couple was entitled to claim a charitable deduction for their contribution of an easement on their historic townhouse, but redetermined its value to be approximately 17 percent of that originally claimed. The Court rejected the testimony of the IRS's expert that the easement had no value, but also found that the taxpayers' expert based his valuation largely on properties that weren't actually comparable to the one at issue. The Court also upheld the IRS's imposition of gross valuation misstatement penalties.

The Facts:

In 1993, George and Leila Gorra, a real estate professional and former tax attorney, purchased a townhouse in the Carnegie Hill Historic District of New York City. In March 2006, a real estate agency listed the property for sale at $5.8 million. The taxpayers reduced the price twice before eventually taking the property off the market a year later.

On December 18, 2006, the taxpayers executed a conservation deed of easement with the Trust for Architectural Easements, which was known at the time as the National Architectural Trust (NAT). On December 20, 2006, the taxpayers also made a $45,000 cash contribution to the trust. On December 26, 2006, a representative of the trust executed the deed on behalf of the trust. Among other things, the deed granted the trust the right to enter and inspect the property, including granting access through the interior of the building. The easement protected existing facades on the front, sides, and rear, as well as the measured height of the property, and required the trust's approval for any changes. Employees of the trust would visit the property annually and take photographs to monitor any changes, and the deed gave the trust the right to bring legal proceedings to remedy any violations. The property was also subject to local Landmarks Preservation law, which required property owners to keep designated properties in good repair and required approval by the Landmarks Preservation Commission in order to perform any work that will affect a landmark's exterior.

Also on December 18, 2006, the taxpayers obtained an appraisal of the property for tax purposes from Jerome Haims Realty. The appraiser, who is a qualified appraiser under Regulation Section 1.170A-13(c)(5), valued the property at $5.5 million, even though it was listed at that time for $5.295 million. The appraisal used the "sales comparison approach" (i.e., before and after) and determined that the value of the easement was equal to 11 percent of the property's market value, or $605,000.

On their 2006 return, the taxpayers reported a $605,000 noncash charitable contribution and deducted $238,778. They deducted a noncash charitable contribution carryforward of $68,456 in 2007. On April 8, 2010, the IRS issued a notice of deficiency for the 2006 and 2007 tax years disallowing the claimed noncash charitable contribution deductions. The IRS also asserted a gross valuation misstatement penalty under Code Section 6662(h) or, in the alternative, an accuracy-related penalty under Code Section 6662(a).

Discussion:

The Tax Court first determined that the taxpayers were in fact entitled to a charitable contribution deduction under Code Section 170(a)(1). It concluded that:

(i) The easement contribution was a qualified real property interest under Code Section 170(h)(2). Notably, the deed granted the easement in perpetuity, the easement was binding on any successors and ran with the land, and the deed specified that the trust would not transfer its rights under the easement unless to a qualified organization under Code Section 170(h)(3) that agreed to carry out the conservation purposes for which it was created.

(ii) The contribution was made exclusively for conservation purposes under Code Section 170(h)(4) and Code Section 170(h)(5). The property was a "certified historic structure" and the easement preserved it as such. The Court also found that, contrary to the IRS's argument, the easement preserved the property beyond that required under local landmarks law.

(iii) The Haims appraisal was a qualified appraisal under Code Section 170(f)(11)(C). Among other things, it contained a description of the property, an expected contribution date, and the method and specific basis for valuation.

The Court then found that the easement was overvalued, although it did not find either the government's or the taxpayers’ experts persuasive on the proper value. It rejected the testimony of the government expert that the easement had no value. Turning to the comparable property sale cited by the taxpayers' expert, the Court first concluded that it would not rely on one sale because the property was sufficiently dissimilar that no reasonable comparison could be made. However, the Court then looked to the second sale and found that, although it involved a larger and wider property with greater value per square foot, the differences in the easements themselves essentially "balance[d] out" these distinctions.

In the end, the Court found that the easement resulted in a 2 percent reduction in value, citing the heightened financial burdens of an eased façade, enforcement actions of the trust, and the scope of the easement. Applying the agreed-upon "before" value of $5.2 million, the Court arrived at a $104,000 value.

The Tax Court upheld the IRS's imposition of the gross valuation misstatement penalty based on the greater-than-200 percent difference between the claimed $605,000 deduction and the Court's $104,000 valuation.

The Court rejected the taxpayers’ argument that the Code Section 6662(h) penalty violates the Eighth Amendment's Excessive Fines Clause. It noted that, since the penalty is calculated as a percentage of an underpayment, it inherently bears a relationship to the gravity of the offense. It also found that Congress addressed the perceived overvaluation of noncash charitable contributions when it reduced the percentage threshold (from 400 percent to 200 percent) for imposing penalties under Code Section 6662(h). This, and other amendments, demonstrate the remedial nature of the penalty and Congress's "intent to regulate" this difficult area.

Conclusion:

Although the Court was not persuaded by either expert, it agreed with the taxpayers that a conservation easement existed and quantified its value at a 2 percent reduction (versus the taxpayers' 11 percent and the IRS's 0 percent). In addition, it applied a gross valuation misstatement penalty since the change in value was greater than 200 percent.